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Bad Bets Rock Fortress's Macro Fund

Wagers on Japanese Stocks, U.S. Rates Deal Blow

Michael Novogratz of Fortress Investment Group Reuters

By

Gregory Zuckerman and

For over a decade, Fortress Investment Group LLC co-founder Michael Novogratz has shared his market predictions in television appearances and high-profile investment conferences.

These days, Mr. Novogratz is addressing something else: how his hedge fund is losing money.

The $3 billion Fortress Macro Fund, which Mr. Novogratz launched in 2002, has lost more than 9% so far this year, with half of that drop coming this month. It is the latest setback for macro funds, which seek to anticipate global economic shifts in various markets. The Fortress loss is worse than most others and stands out following years of market-beating performance.

The culprit? A series of bad bets against U.S. government bonds and the Japanese yen, along with a wrong-way wager on Brazil, investors say.

"We had really aggressive bets in Japanese stocks and U.S. rates and the dollar and in hindsight we were more leveraged than I wished we had been," said Mr. Novogratz, referring to debt taken on by the fund to support its wagers. "You come back to work [each day] angry and frustrated," the 49-year-old said.

Now, Mr. Novogratz said his fund has cut positions and is "waiting for new moments of clarity." He remains bullish on Japanese shares and said the dollar will rise against the yen.

"You can get angry for a little while," Mr. Novogratz said. "But this year isn't over."

To be sure, some of Fortress's largest rivals aren't doing much better: Louis Bacon 's Moore Capital Management LP is down about 5% through mid-October in its main fund; Paul Tudor Jones 's flagship has dropped 2%; and J.P. Morgan Chase & Co.'s Gávea Investimentos arm is down 6%, according to investor updates and people familiar with the firms.

But the average macro fund is up about 1.7% so far this year, according to hedge-fund tracker HFR Inc., after finishing September up 3.8% on the year. About 80% of Fortress's macro rivals have posted stronger performance this year, through the end of the third quarter, according to researcher eVestment.

A Princeton University graduate and former U.S. Army helicopter pilot, Mr. Novogratz stands out in the buttoned-up hedge-fund industry. The former Goldman Sachs Group Inc. executive, who goes by "Novo," earned more than $140 million in Fortress's final two years as a private company and became a billionaire on paper when Fortress went public in 2007. The stock has since fallen, but Mr. Novogratz still owns more than $400 million of shares, according to securities filings.

At one industry conference, he appeared in a white blazer; another time he wore an orange suit jacket. Last year, Mr. Novogratz organized a professional wrestling match in Times Square to promote the sport. His partner, Wesley Edens, purchased a part-ownership stake in the Milwaukee Bucks professional basketball team this spring.

Few investors have pulled out of the Fortress fund, according to a person close to the matter. But some have indicated frustration with performance, raising questions about whether withdrawals will occur at year-end.

The fund continues to charge above-average fees. Investors pay as much as 25% of gains in so-called performance fees, according to a marketing document. The average Fortress investor pays 19.5%. Those fees top the 18% average performance fee hedge funds charge, HFR said.

The woes add to a difficult year for Fortress, which manages other businesses and reports quarterly earnings Thursday. Fortress shares are down about 16% this year to $7.20.

Mr. Novogratz and his fund retain a stellar record. The fund is up about 9% on average, after fees and on an annualized basis, since 2002, despite sizable losses in 2008 and 2011. That compares with annual gains of less than 6% for the average macro fund, HFR said. The fund has bounced back from previous bad years with strong performance.

Fortress's macro business manages less than half what it did in 2007.

Mr. Novogratz's main fund is among those that expected Treasury prices to slump this year, as the economy firmed and investors anticipated higher rates. Instead, prices have climbed.

"We got run over," Mr. Novogratz said.

The fund also lost money on stock bets, particularly those in Asia, as Japan's benchmark Nikkei reversed course on questions about the nation's growth, the firm told its investors.

More recently, the fund has been among those wagering on a rise in the U.S. dollar, while shorting the euro and yen. That trade lost money this month as prospects grew that the Federal Reserve will delay increasing interest rates. Higher rates make a currency more attractive to hold.

Mr. Novogratz had predicted Brazilian President Dilma Rousseff would lose her re-election bid. He positioned the fund for a bounce in the real currency and Brazilian shares, counting on a new business-friendly administration to overhaul the country's economy. "Brazil is so bad, it's good," he said at a conference this summer.

Instead, Ms. Rousseff won Sunday by the tightest margin in the nation's history. The fund has lost money from its Brazilian investments over the past two months, said a person close to the matter, though it has profited from them over this year.

Mr. Novogratz this summer hired Jeff Feig, an ex-senior Citigroup Inc. currency executive, to be the fund's co-manager, a move Mr. Novogratz said should help the fund cut losing positions more quickly. "He wasn't here long enough to get that engaged," Mr. Novogratz said. "He doesn't get any of the blame."

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